INDIA
SUSTAINABLE MICROFINANCE FOR THE INFORMAL SECTOR

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Executive Summary

Until the early nineties, microfinance in India was state driven and state sponsored. Despite the vast bank of branch networks, especially in the rural areas, the Government had to fix targets for lending to various categories of poor. However, directed lending resulted in considerable difficulties for both the borrowers as well as banks. Despite a plethora of Government sponsored programs and a steep increase in bank loans to the poor, timely and adequate credit, the main concern of the poor, was not available from the formal financial system. The failure of the state agencies to provide financial services to the poor resulted in NGOs creating community organizations such as self-help groups, federations of self-help groups and cooperatives for addressing the financial needs of the poor. As a result, two basic types of microfinance initiatives have emerged in the country: the linkage-banking and specialized microfinance institutions.

Under linkage-banking, community based development organizations such as self-help groups, federations, credit unions and other functional groups are linked to formal financial institutions for financial services. The NGOs act as facilitators in this model - forming the groups, building their capacity and linking them with banks for meeting their credit needs. Starting as a pilot project in 1992, linkage-banking is scaling new heights. By March 2001, the National Bank for Agriculture & Rural Development (NABARD) has reported that 265,000 self-help groups in nearly 400 districts had been linked to 318 financial institutions through the participation of more than 750 NGOs. The repayment of loans to banks from self-help groups is nearly 95 percent. While the self-help groups offer an attractive alternative for alleviating poverty, especially among women, the geographical concentration of the self help-groups is skewed with nearly 70 percent of the groups functioning in South India. The challenges in sustainable linkage-banking are: finding a mechanism to fund the cost of formation and nurturing of groups, building the capacity of NGOs in sustaining the groups, and making bankers look at lending to self-help groups and federations as viable business propositions.

Specialized microfinance institutions, the second type of microfinance initiatives, are facing challenges in increasing their outreach and becoming financially sustainable. They are yet to develop core competencies for financial intermediation. Many of them do not have the necessary number of customers to run a sustainable operation. Their legal structure is not suitable for financial intermediation. Therefore, they find it difficult to mobilize resources such as client's savings and loans from financial institutions such as banks, accessing capital markets, etc. However, it is increasingly clear that in order to meet the financial services needs of the poor and low-income households both models need to be encouraged and microfinance institutions (MFIs) need to be linked up with mainstream commercial funding.

The Reserve Bank of India created a Task Force on Supportive Policy and Regulatory Framework for Microfinance in 1998 that gave very comprehensive recommendations for the strengthening of the MFI's in four major areas: the mainstreaming of the sector, regulation and supervision, review of organizational aspects of MFI's; and building capacity of MFI's, banks, self-help groups and others. The Task Force also made very specific recommendations on the type of NGOs/MFIs to be regulated, and encouraged development of self-regulatory organizations as well as the formulation of a separate microfinance act. However, the Reserve Bank believes that the microfinance sector is in its nascent stages, and that the regulation issues need not be considered as of now. While this has

been well intended, it has also resulted in certain unresolved issues - especially in the area of savings mobilization. This has also led to slow development of standards, which is the preliminary step in the creation of self-regulatory organisations.

The Task Force has recognized that the financial services needs of the poor and low income households are nowhere close to being met. While the linkage-banking and specialised MFIs are addressing the credit needs of low and poor income households, the MFI models have not yet adequately addressed the need for liquid and safe savings. The MFI models have also failed to address the need for insurance services for these households.

In order to address the gaps in the microfinance sector, institutions that can design and deliver financial service products in a sustainable manner must be encouraged. The microfinance sector must also work to build the capacity of new and existing players. An analysis of the current demand and supply of capacity building services reveals that the existing training arrangements for the senior level staff of banks, NGOs, MFIs are satisfactory. However, there is a tremendous need to build the capacity of field staff of MFIs, NGOs, leaders of self-help groups and federations. Furthermore, there is a huge gap in the existing arrangements and emerging needs. As the Government of India (GOI) becomes more involved in microfinance, the GOI needs to build its understanding and sensitivity in dealing with the poor so that the movement is sustained. Because many of the MFIs are in the nascent stage of development, they need to strengthen the capacity of their management information systems (MIS) and other systems in order to become sustainable. This involves the participation of consultants who can work as mentors and coaches with some of these organizations. The capacity building is needed mostly on location, with an eye to the costs and time involved in providing required services. Faculty resources and training resources in local languages also need to be developed.

Regarding insurance services, there is a need to strengthen the ability of MFIs to deal with insurance companies. There is also a need to sensitize insurance companies to the needs of the poor and help them design and deliver relevant and user-friendly insurance products.

Presently, a few MFI's have received financing from commercial banks. The lack of equity of many MFI's limits access to commerical financing, decreasing their outreach and retarding their movie towards sustainability. There is also a need to demonstrate to the commercial banks that lending to the MFIs is good business.

Keeping in mind the long-term growth and sustainability of the microfinance market in India, USAID/I can contribute to policy and regulatory issues and building of standards by supporting the network of MFIs involved in policy advocacy and building standards. USAID/I can also play a role in developing new microfinance institutions on a franchisee basis. Supporting specialized microfinance resource centers, which will address the training and capacity building needs of grass root institutions, can contribute to the sustainability of the microfinance movement. A practitioner led training program at the national level and in collaboration with a training institute such as Naropa University in Colorado or Hew Hampshire University can be supported. Setting up an equity fund and an incentive fund can help microfinance institutions to scale up their operations.

A Grant Fund can foster and develop new financial service products as well as encourage innovative approaches in linking microfinance with other sectors - especially business development services. Technical assistance to national level training establishments in order to build the skills of bankers in rating and financing MFIs can be provided. Select exposure visits to other countries can also be supported. Thus, an integrated approach to influence regulatory environment, building capacities and improving the conditions for MFIs to access commercial funding can contribute to the long-term sustainability of the organizations in the microfinance sector.

FOREWORD

The Sustainable Microfinance Institutions of India report presented in this document is the outgrowth of a four-week task sponsored by USAID/New Delhi. The USAID Mission sponsored this effort not just to guide its revised strategy, but more importantly, to be of use to non-governmental organizations striving to play an important role in the micro financial sector, other donor agencies, and other interested parties such as the Government of India.

The limited time allocated to this broad and complex theme made the task challenging. The Team was initially composed of three members: Ms. Girija Srinivasan, a former NABARD and International Bank for Reconstruction and Development (IBRD) staff, microfinance expert and leader in micro insurance services; Dr. Jack Croucher a former Appropriate Technology International (ATI) staff and a business development expert with a broad experience in India; and Dr. Roberto J. Castro, an agricultural economist/microfinance/business development specialist and former US Foreign Service Officer. Because of previous commitments, Dr. Croucher's participation was limited to field visits.

The Team traveled continuously for three weeks covering selected representative areas in all regions of the country, and devoted an additional week for report preparation. The authors were charged with examining the status of the microfinance sector in India, identifying the major obstacles to improving the sustainability of formal and informal financial institutions, with especial attention to NGOs striving to evolve into specialized microfinance institutions. Finally, the Team was to define appropriate responses for the USAID Mission. In spite of the limitation of time for exhaustively addressing these challenging tasks, this document is expected to be of use to the broad audience to which it was intended.

The players in the microfinance sector in India are numerous and from different backgrounds. They comprise formal financial institutions like the National Bank for Agricultural and Rural Developmnet (NABARD) and the Small Industries Development Bank (SIDBI). Other players in the microfinance sector are NGOs like the Self-Employed Women's Association (SEWA), Professional Assistance for Development Action (PRADAN), the Association of Sarva Seva Farms (ASSEFA) and the Mysore Resettlement & Development Agency (MYRADA). Some governmental organizations that participate in the microfinance sector in India are Rashtriya Mahila Kosh (RMK). Multilateral and bilateral donors like World Bank, the Swiss Agency for Development and Cooperation (SDC), the International Fund for Agricultural Development (IFAD) also participate in India's microfinance sector. Finally, commercial banks such as ICICI as well as cooperative banks and regional rural banks play a part in the microfinance sector. Some MFIs started path-breaking work in the provision of financial services to the poor, particularly women. Their work has led to the evolution of Self-Help Groups (SHGs) and their linkage to commercial banks. Other NGOs have been experimenting with various initiatives like replication of Grameen networking of NGOs, and financing through SHGs' federations, cooperatives and non-banking financial companies to provide financial services to their target poor clientele. As a practical matter, therefore, the project's tasks ranged from assessing legal and regulatory issues to examining the workings of selected formal and informal financial institutions as well as organizations providing insurance services in an attempt to understand the dynamics of the microfinance sector in India.

The conceptual and programmatic scope of the study has made the experience very exciting, but at the same time daunting. Given the brevity of time, the authors are aware of how lightly they have touched on a number of important topics, which is reflected in the limited empirical foundation for some of the study's conclusions. The authors are also struck, in general, of how much they still do not know. Conversely, the authors are encouraged by the consistency of the strategic directions that have emerged from the study, and we believe that they constitute a compelling policy and programmatic guide for the future.

In the final analysis, the development of the study comes down to making choices to establish priorities among action programs. The authors tried very consciously to address this challenging task. For ease of presentation and focus, the document concentrates on the overall gaps in the microfinance sector, and looks at a limited, but select number of action programs for USAID/I.

The authors are indebted to a broad range of institutions and persons for their openness, collaboration, and guidance. Although it is impossible to name all of them here, the authors owe them all a sincere intellectual debt. Special recognition is made to the following persons: Mr. Y.C. Nanda, Chairman of NABARD; Mr. Brij Mojan, Executive Director of the Small Industries Development Bank of India (SIDBI); Ms. K.C. Ranjani, General Manager of the SIDBI Foundation of Microcredit (SFMC); Mr. Vijay Mahajan, Managing Director of BASIX; Mr. M. Uday Kumar, Managing Director of the Society for Helping Awakening Rural Poor through Education (SHARE); Mrs. Jayshree Vyas, Managing Director of the Self-Employed Women's Association (SEWA); Ms. Vijayalakshmi Das, Executive Director of Friends of Women's World Banking (FWWB); Mr. K. Narender, Program Leader of the DHAN Foundation; Mr. RK Mukherjee, Director of Grameen Development Services; Dr. Nachiket Mor, Executive Director of ICICI Bank; Dr. Brigitte Klein, Team Leader of GTZ; Mr. Vipin Sharma, Director Southeast Asia/ Cooperative for Assistance and Relief Everywhere (SEA/CARE); Mr. V. Swarup of the Housing and Urban Development Corporation (HUDCO); Mr. Harish Khare, of the Housing and Development Finance Corporation (HDFC); and Mr. Mathew Titus, Executive Director of Sa-Dhan.

The team makes a special recognition to the work and support of Mr. Ashok Jha form USAID/I/ PDEG. This study would have incomplete without his guidance and leadership. He demonstrated superb management skills in arranging for the team's field visits. In addition, he spent considerable time travelling with the team and sacrificing weekends to ensure the team had an exposure to a balanced view of the diversity of experiences in the country. Mr. Jha had an excellent understanding of the problems affecting the microfinance sector. He quickly captured the possibilities of enhancing the sector by taking advantage of experiences in other parts of the world. He is definitely an asset for the Mission. Two other persons deserve recognition, Dr. Prabhu Ghate and Mr. Reed Aeschliman. Both provided useful insights about the sector during the field trips, especially Dr. Ghate with his inquisitive mind and eagerness to learn more about the vibrant dynamics of the informal financial sector in India.

LIST OF ABBREVIATIONS

AP MACS	-	Andhra Pradesh Mutually Aided Cooperative Societies Act
ASSEFA	-	Association of Sarva Seva Farms
BDS	-	Business Development Services
CARE	-	Credit Analysis and Research Ltd
CASHE	-	Credit and Savings for Household Enterprise Project
CDFI	-	Community Development Finance Institution
DCCB	-	District Central Cooperative Bank
EDA	-	EDA Rural Systems, Gurgaon
FWWB	-	Friends of Women's World Banking
GIC	-	General Insurance Corporation of India
GOI	-	Government of India
GTZ	-	Deutsche Gesellschaft fur Technische Zusammenarbelt
HDFC	-	Housing Development Finance Corporation
HUDCO	-	Housing & Urban Development Corporation
IFAD	-	International Fund for Agricultural Development
INAFI	-	International Network of Alternative Financial Institutions
IRDP	-	Integrated Rural Development Program
LAB	-	Local Area Banks
LEAD	-	League for Education and Development
LIC	-	Life Insurance Corporation of India
MACS	-	Mutually Aided Cooperative Societies
MCG	-	Microfinance Consulting Group
M-CRIL	-	Micro-Credit Rating and Guarantees India Ltd
MFAL	-	Marginal Farmers and Agricultural Labourers
MFI	-	Microfinance Institution
MIS	-	Management Information Systems
MYRADA	-	Mysore Resettlement & Development Agency
NABARD	-	National Bank for Agriculture & Rural Development
NBFC	-	Non-Banking Financial Company
NGO	-	Non-Governmental Organisation
NORAD	-	Norwegian Development Agency
PRADAN	-	Professional Assistance for Development Action
RBI	-	Reserve Bank of India
RGVN	-	Rashtriya Gramin Vikas Nidhi
RMK	-	Rashtriya Mahila Kosh
RRB	-	Regional Rural Bank
SBI	-	State Bank of India
SCB	-	State Cooperative Bank
SDC	-	Swiss Agency for Development and Cooperation
SEWA	-	Self-Employed Women's Association
SFDA	-	Small Farmers Development Agency
SFMC	-	SIDBI Foundation for Micro Credit
SGSY	-	Swarnajayanti Gran Swarozgar Yojana

SHARE	-	Society for Helping Awakening Rural Poor through Education
SHG	-	Self-Help Group
SHPI	-	Self-Help Promoting Institution
SIDBI	-	Small Industries Development Bank of India
SIRD	-	State Institutes of Rural Development
SRO	-	Self-Regulatory Organisation

Conversion Factors

Lakh	-	100,000 (one hundred thousand)
Crore	-	10,000,000 (ten million)

I. BACKGROUND

Poverty alleviation has been a major political strategy of the Government of India (GOI) since the late 1970s, and the expansion of formal finance to serve the poor has been perceived as an important means to achieve it. This has led the GOI to intervene heavily in the banking sector in areas such as bank branching policies, mandatory lending quotes, below-market interest rate loans for priority sectors, frequent waivers on loan principals and/or interest, and recapitalization and refinancing of failing financial institutions.

In 1978, the GOI launched the Integrated Rural Development Program (IRDP), a major financial initiative aimed at alleviating poverty. Through this program the government subsidized the interest rates of loans made to the rural poor through the formal banking system, while simultaneously offering additional cash subsidies to borrowers. These incentives contributed to a breakdown in borrower discipline. As a result, starting in 1992, the GOI has implemented financial sector reforms that liberalize and strengthen the financial sector by reorienting banks and other financial institutions towards a market-based financial system, thereby increasing competition and improving quality of financial services.

1.1. Microfinance in India

1.1.1. Demand for Micro Financial Services

Almost 37 percent of India's one billion people live below the poverty line. Out of the 60 million households that live below the poverty line, only 20 percent have access to credit from the formal sector. Both practitioners and service support agencies estimate credit demand at differing level (Rs. 45,000 crores by Vijay Mahajan, Bharti Ramola Gupta and Mathew Titus in 1998; Rs.15,000 crores by EDA Rural systems1). There is general agreement that estimated credit demand breaks down along the following lines: 50 percent is for rural consumption, 24 percent is for rural production, 15 percent is for urban consumption and 12 percent is for urban production. The estimates also confirm that nearly two thirds of the demand for credit is for short-term consumption purposes. The task force further estimates that 75 percent of production needs are met by the formal financial sector while nearly all consumption needs are met by informal sources.

The demand for savings services is estimated to be even higher than the demand for credit (IFAD, 1999). Irregular cash flows taken with small amounts available for savings often deter the poor from using the services of banks. For this reason, poor and low-income households save through post offices and a few specialised savings institutions. However, the need for safe and liquid savings is not met adequately2.

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1 The difference in estimates is due to the per-household need for credit. While the practitioners take the amount as RS. 6000 as the credit demand for the households, EDA Rural Systems estimates the annual credit need as RS. 2000.
2 GTZ has recently commissioned a study in two states of India to quantify poor people's demand for savings services and their present saving mechanisms. Apart from this, there have not been any other major studies.

The demand for insurance services is also substantial. Recent studies (Girija and Ramesh, 2001, FWWB, 2000) have shown that the demand for health, old age pension and asset insurance is high among the women who are major clients of microfinance institutions in India. Similarly, accident, life, health and asset insurance is a high priority among men. Though there are many low premium options for loss-of-life, accidents and loss of assets, there appears to be a low level of awareness among the poor that these exist along with little incentive for agents/ facilitators like NGOs to market the plans. The end result is often a mismatch between insurance plan designs and the requirements of the poor.

1.1.2. Supply of Micro Financial Services

Banks in India are providing micro credit to self- help groups of poor and low-income households under the linkage-banking program. There are also specialized micro financial institutions that provide micro financial services.

a. Linkage Banking

In February 1992, NABARD3 began to support microfinance with a pilot project to test the Self-Help Group (SHG) Bank Linkage Approach designed to cover 500 SHGs4. The intent was to harness the large banking network already in place rather that create special MFIs. Under the linkage banking approach, self-help groups (SHGs) are formed by NGOs (Non-Government Organizations) and linked to formal financial institutions. Self-help groups are neighbourhood groups with 15 to twenty members. The members pool their savings and use them to make loans to other members. Upon successful completion of six months of activity, these groups are eligible to be linked to banks.

Usually an NGO forms the groups and then links it with a bank, but recently some of the branch managers of banks have started forming SHGs. The NGOs can be simple facilitators or act as financial intermediaries. NABARD refinances up to 100 percent of the loans made by banks to the groups at the interest rate of 7 percent. On June 1, 1999, the rates that banks charge to the NGOs or the SHGs, the rate the NGOs charge to the SHGs, and the rate the SHGs charge their members were completely deregulated. As of March 31, 2001, there were 263,000 self-help groups (roughly five million families) linked with banks, and the total flow of credit to them was Rs.4,808 million. The banks participating in this program include 43 commercial banks comprising 27 *public sector banks and* 16 *private sector banks*, 177 Regional Rural Banks (out of 196) and 94 cooperative banks.

NGOs may absorb self-help groups into federations for a variety of reasons. These federations may act as financial intermediaries, as in the case of federations promoted by the DHAN Foundation in Madurai. Some of the federations act only as non-financial organizations working towards

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3 On July of 1982, the GOI created the National Bank for Agricultural and Rural Development (NABARD) as an apex bank to provide credit for agricultural and rural development. It also emerged as a major institution to support institutional development, to regulate and supervise financial institutions, and to develop and implement programs for channeling credit, often at subsidized interest rates, into agricultural and rural activities.

4 Small homogeneous groups of rural poor coming together to save small amounts regularly and mutually contribute to a common fund to be lent to individual members per group decisions

strengthening the groups, providing business development services, and other services. An example of these types of federations is that formed by MYRADA. In the long run, the federations expect to take over the role of the NGOs in nurturing and monitoring the groups.

Since bankers find it difficult to deal with such a large number of self-help groups, there are expectations that future federations will play the intermediary role of routing funds from banks and other apex financial institutions to their member SHGs. While the self-help groups are financially self-sustaining, there are very few federations that have demonstrated financial sustainability5. However, the linkage banking remains the popular model of dispensing micro loans; nearly 70 percent of the ground level disbursements for micro loans has been through this model.

b. Microfinance Institutions

Specialized microfinance organizations (MFIs) have been functioning in India since the 1970s, and at present there are about 400 MFIs6 of varying sizes in the country. The microfinance institutions include NGOs that act as financial intermediaries; Grameen Bank replications; for-profit new generation institutions like BASIX and SEWA Bank; and federations of self-help groups and MACS. Many of them are hybrid institutions and are very small in size. MFIs, which have medium-sized operations, number about 100. As per the discussions with major players and support service organizations, there are as few as ten MFIs that are professionally managed, five of which are operationally sustainable.

These institutions provide financial services and credit to the poor. They mobilize loans from apex organizations like SIDBI Foundation for Micro Credit (SFMC), Friends of Women's World Banking (FWWB), Rashtriya Mahila Kosh (RMK) and others. Some of them also borrow from the promotional grants of NABARD. Private sector commercial banks are evincing interest in financing wholesale and some for profit retail MFIs.

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5 This is primarily due to the fact that most of them are in the formation/stabilisation stages. Areas of concern are the organizational sustainability of these federations in the long run, especially their management by poor, illiterate women, their ability to recruit and retain professional and competent staff, and increasing outreach.

6 The national level data on microfinance is very limited. NABARD tracks certain indicators like the number of groups linked to banks, amounts of bank loans and refinance support for self-help groups. There is no reliable information on some basic but essential details, such as: a) number of organizations acting as facilitators and financial intermediaries; b) Number of groups formed, number of defunct groups, and delinquent groups; and c) qualitative data on the performance of financial intermediaries including banks such as outreach, portfolio quality, efficiency of operations and sustainability.

1.2. Relationship to USAID's and Mission's Strategy

1.2.1. Agency's Goals

The U.S. Agency for International Development (USAID) supports microenterprise development to advance its strategic objective of expanding economic opportunities and access to financial services for the poor, specifically the many poor who operate or work in microenterprises.

The primary development goals for the USAID's Strategic Objective of expanding economic opportunity and access to financial services for the poor are:

- Helping the poor increase their incomes and assets;
- Increasing skills and productivity to enhance economic growth;
- Supporting sustainable organizations that provide resources to disadvantaged groups.

In June of 1994, USAID launched the Microenterprise Initiative, which commits the Agency to four basic principles in the design and implementation of microenterprise activities. These are:

- Maintaining focus on women and the very poor
- Helping implementing organizations reach a greater number of people.
- Supporting institutional sustainability and financial self-sufficiency among implementing agencies.
- Seeking improved partnership with local organizations in the pursuit of microenterprise development.

1.2.2. Mission's Strategic Objective

The USAID/I Mission, in support of the Agency's Microenterprise Initiative, has adopted Strategic Objective No. 386-011, with the primary objective of improving the capacity of financial markets, both formal and informal. Among the activities that will contribute to achieving this key developmental goal is "Building technical and managerial capacities of microfinance institutions (MFIs) to help them achieve sustainability and facilitating a regulatory framework that promotes efficiency of the MFIs."

1.3. Objective of the Study

The main objective of this document is to address the major constraint facing micro entrepreneurs in India: <u>the lack of access to savings and credit services provided by the banking sector</u>. This reluctance on the part of commercial banks to provide credit to micro enterprises is due to a host of reasons, including micro entrepreneurs inability to provide adequate collateral on loans as well as well as lack of insurance products that create payback safety nets for the clients. The proposed interventions presented in this document are consistent with USAID's Microenterprise Development Policy Paper and seek to support the steady development of a sustainable intermediation system that will provide full financial services to microenterprises. These interventions seek to promote financial deepening, introduce best practices, and promote a large-scale expansion services provided by unregulated and regulated microfinance intermediaries to diverse client sectors and geographical areas.

II. CONSTRAINTS TO SUSTAINABLE MICROFINANCE

2.1. Legal and Regulatory Framework

2.1.1. Legal Framework

The organisational and legal classification of microfinance institutions determines their ability to transform themselves into sustainable organisations in the following areas: access to commercial funding; ability to reach self-sustaining operational levels; and success at making improvements to institutional development. Constraints in these areas may limit the ability of Indian microfinance institutions to grow and develop.

Organizational and legal forms available to microfinance institutions in India are:

a. Self-help groups and women groups (*mahila mandals*): Informal neighborhood groups that provide savings and credit services, along with operating community-based programs.

b. *Federations of SHGs:* Self-help groups clustered into federations and/or block/*mandal* federations. The apex federations are usually registered as societies and trusts under the Societies Registration Act of 1860 or the Indian Trusts Act of 1882. In Andhra Pradesh, these federations are usually registered as Mutually Aided Cooperative Societies (MACS).

c. Facilitator NGOs: NGOs who act as facilitators in forming self-help groups and linking them with banks are registered as societies and trusts.

d. *Financial Intermediary NGOs*: NGOs involved in microfinance as financial intermediaries, often registered as societies and trusts. May include some apex/ wholesale lending institutions.

e. *Non-Profit Companies*: The few companies that registered as non-profits under Section 25 of the Companies Act of 1956 ("Section 25 Companies").

f. *Cooperatives*: MFIs can register as cooperatives, thrift cooperatives (such as the Cooperative Development Foundation in Andhra Pradesh) or urban cooperative banks like SEWA bank, MACS, and others.

g. *Non-Bank Finance Companies*: MFIs registered as formal financial institutions licensed by the Reserve Bank of India. These include local area banks (LABs), and non-bank finance companies registered under the Companies Act of 1956, such as those established by BASIX, and SHARE.

Legal forms and the relevance for microfinance

Aspect	**Not for profit**			**Mutual Benefit**			**For Profit**	
	Societies	**Trusts**	**Sec. 25 companies**	**MACS**	**State cooperative societies**	**Urban cooperatives**	**NBFC**	**LAB**
Registered under	Societies Registration act, 1960	Indian Trust Act, 1920	Companies Act, 1956.	AP MACS Act, 1995	State cooperative act	State or central multi state co operative act	Companies Act, 1956.	Companies Act, 1956.
Ownership	No ownership	No ownership	Shareholders	Shareholding members	Shareholding members	Shareholding members	Shareholding members	Shareholding members
Management	Governing Board	Board of Trustees	Elected Board	Elected Board of Directors	Elected Board of Directors	Elected Board of Directors	Elected Board of Directors	Elected Board of Directors
Accountability	Less accountable	Less accountable	Greater accountability.	Greater accountability. Less scope for interference from vested interest groups.	Less accountable. High scope for interference by vested interest group	Greater accountability. Less scope for interference from vested interest groups.	Greater accountability	Greater accountability
Regulation of microfinance	No license for microfinance Registrar of Societies monitors.	No license for microfinance. Registrar of Trust monitors.	No license for microfinance. Registrar of Companies monitors.	Microfinance under the MACS Act. Registrar of Cooperatives monitors.	Microfinance under the State Co operative Societies Act. Registrar of State Cooperatives monitors.	Microfinance under license form RBI under Banking Regulation Act, 1949. RBI and Registrar of Cooperatives (State/ National) monitors.	Microfinance activity under RBI Act 1934, NBFC rules. RBI and Registrar of companies' monitors.	Microfinance under license form RBI – under banking regulation Act, 1949. RBI and Registrar of Companies monitor.

Aspect	**Not for profit**			**Mutual Benefit**			**For Profit**	
	Societies	**Trusts**	**Sec. 25 companies**	**MACS**	**State cooperative societies**	**Urban cooperatives**	**NBFC**	**LAB**
Entry barrier for microfinance	No entry barrier. Registration is very easy.	No entry barrier. Registration is very easy	No entry barrier. Registration is relatively easy	No entry barrier. Registration is relatively easy	No entry barrier. Registration is relatively easy	Entry barrier is there. Entry-level risk capital is Rs. 5 million. Obtaining license from RBI is quite difficult.	Entry-level risk capital is Rs. 20 million. Registration is relatively easy unless the NBFC wants to mobilize savings that requires license from RBI.	Entry-level risk capital is RS. 50 million. Obtaining license form RBI is very difficult.
Capital adequacy	No capital adequacy norms	No capital adequacy norms	No capital adequacy norms	No capital adequacy norms	No capital adequacy norms	Capital adequacy norms are 10% – 12 % of risk weighted assets	Capital adequacy norms are 10% – 12 % of risk weighted assets	Capital adequacy norms are 10% – 12 % of risk weighted assets
Prudential norms	No prudential norms for income recognition and asset classification	No prudential norms for income recognition and asset classification	No prudential norms for income recognition and asset classification	No prudential norms for income recognition and asset classification	No prudential norms for income recognition and asset classification	Prudential norms for income recognition and asset classification exist.	Prudential norms for income recognition and asset classification exist.	Prudential norms for income recognition and asset classification exist.

Deposit regulation	No clear guidelines on whether savings deposits can be mobilized, the types of deposits to be taken, interest payable on deposits and deposit insurance.			Clear guidelines on deposit taking including types of deposits and interest payable on deposits		Norms for deposit taking are laid down though they are deregulated. Deposit insurance exists.	Deposit taking is well regulated and is restricted unless the NBFC is rated A. Severe restrictions on types of savings to be taken.	Deposit taking has clear norms and is de regulated for long-term deposits.
On lending interest rates	No regulation on on-lending interest rates			On-lending interest rate deregulated			On-lending interest rate deregulated	On-lending interest rate deregulated
Transparency as MFI	Easy to establish but less transparent.	Easy to establish but less transparent	Easy to establish but greater transparency as compared to trust or society	Easy to establish and high levels of accountability	Low level of accountability/ transparency due to political interference.	High level of accountability and transparency as MFI	High level of accountability and transparency as MFI	High level of accountability and transparency as MFI

Source – Legal and procedural Constraints in Microfinance, AIAMED and Opportunity International**.**

2.1.2. Main Constraints of the Legal Forms in Microfinance

a. *Societies and trusts* formed from non-profit NGOs operate under severe constraints to expand microfinance activities. If these organizations are earning substantial income under lending operations, the income tax assessing officer can conclude that the major activity of the organization is not charitable and hence the NGO can face the risk of losing its charitable status and resulting exemptions from income tax. These organizations cannot utilize commercial banks for loans or equity capital from commercial sources. The savers and borrowers are not members of these NGOs and hence cannot contribute to the equity. Thus, these NGOs find it difficult to scale up operations due to restrictions placed on accessing commercial loans, savings mobilization, raising equity and the inability of the borrowers to become part of the governing body or to contribute to equity.

b. *The mutually aided cooperatives (MACS)* are presently working in Andhra Pradesh on a bill that would amend the Cooperative Societies Act. Similar legislation that encourages MACS is in progress in six other states. The potential for increasing outreach is a constraint under this legal format because MACS are member-owned organizations with work restricted to a particular block/*mandal*. However, since the transaction costs of doing business is lower in MACS and access to their members' savings can contribute to lowering the cost of funds, this model is expected to be financially sustainable.

c. Other forms of microfinance institutions such as *Section 25 Companies, Non-Bank Finance Companies* and *Urban Cooperatives* can accept equity funds from local and foreign investors and obtain loans from commercial banks. BASIX has recently received both Indian and foreign investment capital. However, there is a perception among practitioners that this is the exception rather than the rule. There is also a perception that Section 25 Companies allowed to be registered with no capital may find it difficult to raise commercial loans later, unless they either bring in capital through equity or grants. Non-bank finance companies, LABs and urban cooperative banks are not currently popular among Indian MFIs due to relative difficulties in obtaining registration, raising the entry capital, and complying with the sophisticated reporting and regulatory requirements by the Reserve Bank of India.

2.1.3. Regulation of Microfinance Institutions

The main objectives of a system of regulation and supervision of MFIs are:
- Protecting savers or depositors (prudential concerns);
- Promoting healthy growth in the sector towards financial and institutional sustainability and greater depth of outreach through setting performance standards and encouraging best practices;
- Monitoring the sector (its size, structure and growth in terms of portfolio, disbursements, number of MFIs and borrowers, savings mobilized, other sources of funds etc.), which is primarily a statistical objective.

Based on these objectives, the Task Force set up by Reserve Bank of India has made specific recommendations on the regulation of MFIs, including modes of regulation, registration and classification of MFIs, regulation of MFIs that mobilize deposits, and prudential norms for MFIs. It has also made very specific recommendations on the type of NGOs/ MFIs to be regulated, encouraging self-regulation within the organisations and the formulation of a separate microfinance act.

However, Reserve Bank has held the view that the microfinance sector is in a nascent stage and hence, the issue of regulation is not priority. While this view is well intended, it has resulted in certain unresolved issues, especially in the areas of savings mobilisation among members and the establishment of self-regulated organisations.

2.1.4. Private MFIs Networking

The regulatory framework needs to be developed by the central bank in consultation with industry leaders, including the leading MFIs. Private networks/associations of MFIs have a greater role to play as policy advocates of regulatory issues. They can also ensure self-regulation of members by developing standards and encouraging compliance by their members.

There are four to five major networks of MFIs/NGOs in India. While some are national networks, a few are regional in nature. Some of the major microfinance institutions and NGOs involved in the formation of SHGs have formed the Sa-Dhan network of microfinance institutions. BASIX, SHARE, SEWA Bank, FWWB, MYRADA are among its members. This network has three core functions: a) policy advocacy, b) development of standards, and c) capacity building. The organization sees the first two functions as the most critical, restricting point C, capacity building, to educating members about microfinance, sustainability and standards. At present, the organization appears to be negotiating a role within the policy area. The organization has forty-six members and has the potential, over the long term, to work as a self-regulatory organization (SRO). As a preliminary step to becoming a SRO, Sa-Dhan has initiated standards development7 for the industry, especially for its members. It has plans to increase its membership to eighty organizations within the next three years, while playing a greater role in the development of standards and policy advocacy.

Sa-Dhan is being funded from grants from Ford Foundation and membership fees from participating institutions. Funding constraints have been faced and Sa-Dhan remains a modest initiative. However, it is by far one of the larger networks built from MFIs.

2.1.5. Strategic Intervention by USAID in Policy Advocacy and Regulation

One way to contribute to sustainable microfinance delivery in India is to support the private networks of MFIs that are building capacity in the areas of policy advocacy, the development of an enabling legal and regulatory environment, and the creation of standards based in best practices. No donor agency is funding these initiatives in any substantial manner. For that reason, we recommend that USAID India consider supporting Sa-Dhan and along with other similar networks after due diligence.

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7 Sa-Dhan has held six consultation workshops around the country. In October 2001, its members identified the following performance standards for consideration: operational self-sufficiency, administrative efficiency, operating cost ratio, client to staff ratio, current repayment rate, and portfolio at risk. In addition, non-financial standards relating to governance and the extent of coverage of the poor have been also proposed.

2.2. Institutional Capacity of the Microfinance Sector in India

2.2.1. Financial Sustainability and Outreach

a. Linkage Banking

NABARD has a very ambitious target of expanding outreach under the linkage-banking program. It aims to promote one million SHGs and reach 20 million families by 2008. To achieve outreach to one million SHGs, it would require the participation of 25,000 bank branches, 4,000 NGOs, 2,000 self-help federations and about 100,000 personnel of NGOs and banks. In addition, it will require considerable funds (US$ 75 million) for building the groups and the capacity of other key players.

The **constraints** to achieving this target and ensuring sustainable linkage banking are the following:

i. Insufficient financial, human and institutional capacity among the NGOs who are acting as facilitators: While linkage banking is quite popular, the system does not provide for the cost of the NGO; the NGO is not reimbursed by either the group that receives access to financial services or the bank that gets a good client.[8] For that reason, NABARD has introduced a scheme for reimbursing the costs for NGOs ready to link of groups to banks. While there are some views that the amounts reimbursed are low and the procedure time taking, it is worth mentioning that a dedicated microfinance development fund has been set up by NABARD with support from the banking system. However, if outreach is to be increased and existing groups are to be strengthened, the process requires a mechanism to finance the cost of formation of groups in a user-friendlier manner.

The human and institutional capacity of many of these facilitators is limited, especially in sustaining the groups. This will be discussed in greater detail in the chapter on capacity building.

ii. Negative attitude of bankers who believe that linkage banking is not profitable: NABARD has arranged for various training and exposure programs for bankers that aim to change their mindset about lending to the SHGs, as well as enhance their knowledge and skills in dealing with clients. While this has helped step up the outreach of banks, the concern is that very few of them consider lending to SHGs a viable business proposition. Many of them still believe that linkage banking is not profitable since the volume of business generated through SHGs in many of the branches has not reached a critical mass. Very few banks have been sufficiently creative and sensitive to carry out innovations in lending to the poor.

iii. Banks and Government as self-help group promoting agencies: Although more and more bank branch managers and Government officials are taking on the task of forming groups, there are a number of unresolved issues involved with promoting SHGs. First and foremost, the groups formed

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8 According to NABARD, formation of groups has been incorporated as an add-on activity by the NGOs, which were already implementing other programmes. Therefore, the incremental costs of group formation and continued support are often unattractive. NGOs have to mobilize funds from donors to meet the cost of formation of groups since at present there is no incentive for the NGOs in the facilitator model. However, larger funding support to enable expansion of work can be difficult to come by and unpredictable once secured.

by bank and government agencies, having been subjected to financial intermediation, lack the vibrancy seen in NGO-promoted groups. The quality and sustainability of these groups is also suspect. Furthermore, there is high turnover within both bank and government agencies, and incumbents may not share the same zeal in nurturing the groups as their predecessors.

b. Specialized Microfinance Institutions

Specialized microfinance institutions face challenges to increasing their outreach and financially sustainability. The following is a discussion of some of the more common problem areas.

i. Limited number of MFIs: The number of microfinance institutions in India ranges from 400 to 500, including both large and small agencies. One constraint faced by prospective MFIs is the lack of technical know-how needed to get off the ground and grow into sustainable organizations. Replicating proven models may be one solution to increasing the number of MFIs.

ii. Little concern about sustainability of operations: Micro-lending in India is carried out by a variety of hybrid financial intermediaries, including SHGs, federations of SHGs, village level networks, etc. Many NGOs have added the financial intermediation role to their existing social intermediation work, since they have realized that some part of the cost of formation and nurturing of the groups can be recovered/collected through this route. However, the sustainability of these organizations is unproven due to a host of reasons, among them:

- *Lack of skills for financial intermediation*: NGOs have yet to develop competency in providing the new financial services.
- *Limited outreach*: Many NGOs don't have the necessary outreach to operate sustainably.
- *Unsuitable legal form:* Their legal form is not suitable for financial intermediation, and hence they find it difficult to mobilize resources such as client savings, loans from financial institutions such as banks, capital markets, etc.
- *Weak tracking systems*: Most of them have very weak systems to track the performance of microfinance programs.
- *Charity orientation*: Since many of these institutions were previously involved in charity programs, they may still consider microfinance as a means to provide welfare to low-income households. For this reason, there is little concern about sustainability.

A recent report generated by a rating organization that tracked 53 MFIs rated in South Asia (44 of which were in India) revealed a similar pattern of MFI financial weakness. The total volume of lending in the Asian study group was less than one-third the portfolio of BancoSol in Bolivia and much smaller than just one large MFI in Bangladesh, the Grameen Bank (ASA). Savings mobilization performance demonstrated the limited value placed on savings services and the constraints that non-bank finance companies and other MFIs face in when attempting to mobilize voluntary savings. Few could cover their operating costs and none could operate completely free of subsidies.

iii. Limited availability of equity/quasi equity funds: At present, most of the Indian MFIs are registered as not-for-profit MFIs called societies or trusts. These non-profit MFIs cannot reach equity by definition. Section 25 Companies that can be started with no equity will find it difficult to scale up operations with no equity or quasi-equity, since leveraging for commercial loans becomes increasingly difficult. Similarly, mutual benefit organizations like federations of SHGs that are member owned (with predominantly poor women as members) require infusion of equity in order to scale up operations. The for-profit MFIs, especially NBFCs, require an equity of Rs. 20 million simply to start operating.

Nonetheless, there are many MFIs in the form of societies and trusts that have sizeable operations. In order to scale up and become sustainable, they are likely to take the legal classification of Section 25 Companies or NBFCs. Many of them may require an equity between Rs.2,500,000 and Rs.5,000,000. A few of those that adopt the legal classification of NBFCs can require up to Rs.20 million in order to scale up operations. Similarly, some federations registered as MACS that are on the path to becoming sustainable may find that they are unable to leverage more loans because their members' equity contribution is low. These MACS may require Rs. 500,000 to 1,000,000 to scale up operations. At present, the availability of capacity-building funds and loanable funds is high, whereas availability of equity funds is low to non-existent.

2.2.2. Limited Financial Services for the Poor

Low-income households deserve access to financial services that help cope with risks, setbacks and emergencies while providing opportunities to invest in productive assets and existing business. Standard financial services needed by the poor are savings, loans and insurance. Since many poor households use savings and credit mechanisms as substitutes for insurance, all three technologies should be treated in a unified way. The poorer the household, the greater the need to use savings and credit as insurance substitutes. While the need for credit is being met to some extent, the need for safe and liquid savings and insurance services is not. Thus, at present, the low-income households save through post offices and other informal institutions. However, these savings are not used by the institutions for micro loans.

a. Limited Savings in Banking Linkage

Many SHGs follow the principle of fixed savings per member to simplify accounting and to discourage members with more savings from demanding larger loans and becoming more influential in the group. Most of the groups do not allow for quick withdrawal of savings. In the case of emergency, a member can default on a loan. For this reason, there is little opportunity for members to access safe and liquid savings' instruments under linkage banking.

b. Lack of Savings Opportunities in Specialized Microfinance Institutions

Some of the NGOs/microfinance organizations mobilize small amount of their clients' savings. However, this activity is technically illegal, since NGOs' legal classification does not allow this type of operation. The reason for such legal barriers is that NGOs and other unregulated organizations have not adopted prudent financial norms and cannot cover the members' savings under deposit insurance. Therefore, there is little protection for poor members who have placed savings in the hands of unregulated MFIs.

c. Inadequate Micro Insurance Services

Insurance services offered to poor and low-income households are inadequate. Present hurdles faced by formal insurers include a lack of orientation in dealing with poor; the perception of high transaction cost in servicing this clientele; a lack clear understanding of the needs of poor; and cumbersome procedures. Similarly, the poor are often unaware of insurance services, especially general insurance. Women in particular are not covered by insurance as many consider the formalities of formal companies beyond their comprehension. In addition, the poor are apprehensive about working with insurance companies since claim settlement procedures are not user-friendly, and their past experience in settling claims in a timely fashion and for an adequate amount has not been good.

Given the weaknesses of the existing arrangements for formal insurance, some of the NGOs/ MFIs are offering insurance services to their clients/members as in-house programs, a phenomenon that is not very desirable9.

Since formal insurance companies with good agency network are present in India and the NGOs/MFIs can facilitate providing linkages between clients and formal insurers, there is a potential for a joint effort that could result in a win – win situation for all concerned.

d. Need for Policy Measures for Micro Insurance

Policy measures should continue activities aimed at increasing insurance services offered in rural areas, especially to the rural poor. In an effort to ensure at least minimal coverage for the rural poor, IRDA has stipulated that a certain percentage of policies should be underwritten from disadvantaged areas and sections of population. However, this emphasis on number of policies alone does not provide meaningful coverage in the rural areas. Adequate coverage can only be facilitated by stipulating a combination of minimum percentage of number of policies along with total amounts underwritten.

In the case of partnering with formal insurance companies (linkage insurance), NGOs/MFIs can become facilitators now and later become agents if the bill for amendment of corporate agency is passed. The transition would require adequate compensation for their services in providing product design support, a potential client database, support for claim application procedures, as well as a marketing campaign to build awareness.

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9 There are very few MFIs that are managed professionally and whose programs are sustainable in the long run. They have considerable difficulties in managing their lending programs and very few of them offer voluntary savings facilities to their clients. Some of the MFIs foray into insurance in order to be viewed as full service providers without realising that this product requires highly technical skills, sound management and capable staff. Most importantly, from a legal perspective, insurance products cannot be offered by organizations that are not licensed by IRDA. Many of the MFIs/NGOs that offer insurance services are not complying with any of the present norms of IRDA for minimum capital, reserves, and investment of income.

2.2.3. Strategic Intervention by USAID in Scaling up Microfinance Initiatives and Microfinance Services

In its efforts to diminish the gaps and challenges to MFIs' scaling-up and outreach activities, USAID can support the following activities:

- Enable replication of successful models of microfinance by franchise method, contributing to the expansion of sustainable organizations.
- Set up both an equity fund and an incentive fund for contributing to the equity of sustainable MFIs.
- Provide technical assistance in the form of research of client needs for financial services, impact assessment of microfinance, etc.,
- Facilitate provision of sustainable micro insurance services by funding initiatives that advocate for well-designed insurance products that are based on assessments of client needs. Follow up with promoting the design and delivery of user-friendly insurance products.
- Build capacity in linkage banking, which is covered in more detail in next section.

2.3. Capacity Building Needs of the Microfinance Sector – Existing Arrangements and Gaps

2.3.1. Linkage Banking

In order to facilitate a linkage program, the group members, group leaders, federation leaders, NGO personnel and bankers who deal with the groups will require periodic training and exposure. The GOI has recognized microfinance as a poverty alleviation tool and has introduced this tool in the form of major policy, such as SGSY. Thus, GOI personnel will also require training and exposure to the concept.

The present gaps in capacity building for the different participants in the microfinance sector are the following:

a. Banks:

Training sessions currently tackle the need to generate an attitudinal change among bankers, as well as developing the skills necessary to deal effectively with SHGs. However, there is a need for additional training. Bankers need to be trained to view financing microfinance institutions as a business opportunity through understanding the various models of microfinance institutions. This would include gaining knowledge of the operations of SHG federations, rating and assessing these institutions, setting interest rates to cover costs, among other themes. Those needs could be addressed by any of the existing training institutions for bankers.

b. NGOs as Self-Help Group Promoters:

The NGO staff at different levels requires specialized skills. Those at senior levels need conceptual clarity and visioning skills, financial management expertise and community mobilization skills.

Those at junior levels need to be well versed in poverty assessment, group formation, accounting, auditing and training. Others have to be involved in providing BDS services. All staff needs to have interpersonal skills such as the ability to communicate and relate to clients.

At present, most of the NGOs staff does not receive quality training because of the following reasons:

- It is unattractive to send staff to distant places in light of the time and cost involved.
- Language is a barrier to training sessions and exposure visits arranged outside of the NGOs' states.
- Although senior and middle level staff of NGOs can be trained in classrooms, the field level staff requires a mixture of classroom training and on-the-job exposure.
  This type of quality training on-location is rarely available at reasonable costs.

c. Self-Help Groups and other Community Based Development Organizations

Community Based Development Organizations include SHGs, federations of SHGs, and user groups involved in microfinance, such as water user groups, joint forest management groups, etc. Present arrangements to train these grassroots' level organizations have been found inadequate by all concerned – NABARD, NGOs, Federations etc.- primarily due to the following factors:

- Most NGOs themselves are unable to provide good training to the groups promoted by them as they are involved in various community development activities and do not find the necessary time and resources.
- They find it inconvenient to send their group leaders to distant places in view of the time and cost involved.
- Language is a barrier in training and exposure visits arranged outside the state.
- The group leaders require a mixture of classroom training and on-the-job training of a longer duration considering their present literacy levels and learning capacity.
- Quality training on-location is rarely available at reasonable costs.
- NGO staff turnover rate is high and hence they are not interested in investing time and resources on specialist trainers. This results in a poor quality in house training for the groups and the members.

d. Government Institutions

Some state governments have made group-based approaches a part of their development intervention design. Many development projects include plans to integrate bank linkage into savings and credit programs. However, some Government officials are not well equipped with the social skills required for mobilising people, forming groups and sustaining them. Therefore, they will require training to develop these special skills. They also need courses in microfinance concepts in order to gain the appreciation, understanding and necessary skills for dealing with SHGs and other community based development organisations. As GOI officials are usually trained by the State Institutes of Rural Development (SIRD) formed in most of the states to train the Government staff, this is the logical institution to sponsor the training.

2.3.2. Specialized Microfinance Institutions

All levels of organizations working in micro lending – from wholesale lending institution to microfinance institutions to grass root level community based development organisations, require specific capacity building programs. The following section discusses the training options at each level.

a. Wholesalers

Indian wholesale lending agencies include SFMC, RMK, FWWB and HUDCO. The training needs of the wholesaler staff are currently met by sending them abroad to specialist courses run by EDA Rural Systems, IBRD and Microfinance Consulting Group (MCG)[10] in India. These wholesale lending institutions train their staff to deal with MFIs as clients and adjust their business environment to incorporate this sector.

SFMC utilizes the services of consultants for a variety of assignments. MFI ratings performed by EDA Rural Systems reveals that only a handful of Indian MFIs (less than 10) are highly credit worthy. Many other are in the start-up stage, and these young MFIs require considerable capacity building. SFMC arranges for competent consultants to mentor and coach some of its client organisations.

FWWB arranges training programs for various levels of the staff of its clients. It also holds that this capacity building requires a "one-on-one" ratio separate from its general training. Thus, the organization plans to work with five institutions each year to building their capacity as growing MFIs. Since USAID is already supporting FWWB's general training and its hand-holding initiative, there is no need for further support to wholesalers' training.

b. Microfinance Institutions

The microfinance institutions include NGOs that are acting as financial intermediaries, Grameen replicators, the for-profit new generation institutions like BASIX and SEWA Bank, Federations of SHGs and MACS.

May times the training and capacity building needs of these organizations differ depending on the maturity of the program. However, all MFIs require strengthening in MIS, improved technology for managing delinquencies, better financial management, skills in fundraising and more efficient human resources management. At present, there are a number of institutions providing such training to MFIs; among them are EDA Rural Systems and BIRD.

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10 MicroFinance Consulting Group is a professional organisation providing high-end training courses in microfinance.

2.3.3. Capacity Building for Insurance Services

Looking to the present stage of development of micro insurance market, the crucial role for donors is in the capacity building of various stakeholders in the following areas: understanding the micro insurance market; analyzing clients' needs; and developing and delivering appropriate products. The capacity building needs of various primary stakeholders are summarized in the table below.

2.3.4. Summary of Gaps in the Capacity Building Arrangements

The following summarizes the training environment within the microfinance sector in India:

- The trainees are many whereas the existing arrangements and skills available are limited.
- The existing training arrangements for the senior level staff of banks, NGOs, MFIs are satisfactory and there is little gap to be filled.
- There is a tremendous need for capacity building among the field staff of MFIs, NGOs, leaders of SHGs and Board members of federations, where there is a huge gap between existing arrangements and emerging needs.
- With the GOI becoming more involved in microfinance, there is a need to increase understanding and sensitivity to working with the poor so that appropriate policy decisions are made.
- Since many of the MFIs are in the nascent stage of development, there is a need to build their capacity, especially in MIS and other systems development, so that they become sustainable agencies. This will involve bringing in consultants who can work as mentors and coaches with some of these organizations for a period of time.
- Capacity building is needed mostly on-location, keeping in view the costs and time involved. This implies that some of the programs need to be conducted at the district/ grassroots level where training resources are limited.
- The language used in training is another key factor. The vernacular should be the language used for training the staff of grassroots institutions and the members of SHGs.
- Faculty resources and training resources in local languages need to be developed.

STAKEHOLDERS' CAPACITY NEEDS FOR INSURANCE SERVICES

Stakeholder	Aspects
Formal insurance companies	Change in mindset and attitudes about low-income households. Understanding financial services needs of the poor and low-income households and the role of insurance in reducing their vulnerability. Working with NGOs/ MFIs. Building empathy and trust among the three participants: insurer, MFI facilitator and the NGOs and its clients.
NGOs/MFIs	Market research to analyze clients' needs for financial services, especially in insurance products and coverage. Development of simple tools and cost effective mechanisms

	to estimate the demand for insurance. Understanding insurance services and terminologies. Gain ability to compare various insurance products to analyze terms, benefits and exclusions. Develop skills to negotiate with insurers. Train clients to deal effectively with the insurance companies' regulations to make insurance work for their needs.
Clients	Develop understanding of formal insurance. Deal with insurance companies and their regulations. Learn how to make the best use of insurance facilities, especially in the case of health insurance.

Source – Girija Srinivasan, Linkage Insurance to poor and low-income households, Draft paper, GTZ India, October 2001.

2.3.5. Existing Funds Available for Capacity Building

NABARD has set up the Microfinance Development Fund, with a net of Rs. one billion formed from contributions from commercial banks and the Reserve Bank of India. This fund is to be used to fund the formation of groups, generate capacity building, train partner organizations (banks, NGOs and community-based organisations like SHGs), fund some research initiatives and studies, and support specialised MFIs. The terms of usage of these funds and their allocation for various purposes have yet to be worked out. However, it is expected that the quantity will be sufficient for the next two years since this fund is likely to be used predominantly to fund the formation of groups.

Similarly, SIDBI has a capacity building grant from DFID in the amount of Rs. one billion that is to be used for arranging training for its partners, funding studies, providing mentoring services, etc. In addition to these two major funds, there are other capacity building funds available with RMK, HUDCO and HDFC. According to Sa-Dhan, there are nearly four billion rupees available through apex organizations (other than NABARD) for capacity building. However, as per the practitioners' statements, timely and adequate access to these funds is difficult.

2.3.6. Strategic Intervention by USAID in Capacity Building

Looking at existing arrangements and gaps, USAID can contribute to the sustainability of the microfinance sector by:

- Supporting the start up of institutions providing grassroots-level training in a cost effective and innovative way. CARE India is planning to set up CARE Academy of microfinance and has developed a very cost effective and innovative business model.

- o Providing technical assistance to organizations that have plans to develop good training modules etc.,
- o Enabling practitioner-led training courses for MFI and bank staff.
- o Supporting organizations that are providing mentoring services to young MFIs. However, this may not be a priority given funding limitations for such initiatives.

2.4. Enhancing Commercial Banks Role into Microfinance

A number of commercial banks do not visualize "Banking with the Poor" as a viable business opportunity; they support it as a social obligation. The main constraint in the flow of credit to asset-less poor borrowers seems to be the comparatively high transaction costs to banks in financing a large number of small borrowers who require credit frequently and in small quantities. The same holds true of the costs involved in providing savings facilities to the small, scattered communities in rural areas. Additional issues include: a) the perception of risks in financing small borrowers who are unable to offer hard collateral; b) the urban orientation of field staff and their mindset; c) inflexibility in their operations in terms of procedures and policies. These constraints restrict the outreach of the formal banking system to the poor.

2.4.1. Mainstreaming Microfinance and Role of Commercial Banks

At present, the commercial, cooperative and regional rural banks are taking an active interest in lending to SHGs under the linkage-banking program. Although this program has many advantages for banks - high recovery performance, reduction in the transactions costs for both banks and MFIs, reasonable profit margins for both and an opportunity for banks to get future quality clients, both for deposits and loans - banks have yet to appreciate this as a business opportunity. At present, the main incentive for commercial banks to participate in the banking linkage program is NABARD's 100% refinance policy of bank loans to SHGs at 7 percent per annum.

The interest rates that are charged by formal banks when lending to the MFI sector, especially to SHGs, have been de-regulated. Although there is no longer an issue of interest rate controls, the public sectors' commercial and regional rural banks, which are the major partners in the linkage banking program, do not see this sector as a business opportunity. They support it as a social obligation. Banks must consider revising their rates to reflect the transaction costs and risk of lending to this sector. This requires changing banks' perception that increased interest rates imply exploitation of the poor, and also changing their focus to include providing the poor with adequate financial services.

Some of the private sector banks are keen to lend to wholesalers like FWWB. So far, their interest has been in fulfilling the priority sector lending norms. However, they expect guarantees from donors before lending to wholesalers.

2.4.2. Strategic Intervention by USAID

a. Motivating Commercial Banks to lend to specialized Microfinance

Institutions – Role of Development Credit Authority

Commercial banks perceive the poor as high-risk clients because of the high transaction costs in dealing directly with this population. They also hesitate to lend to MFIs given the weak financial position of most MFIs providing financial services. Consequently, to improve the financial deepening of select commercial banks and promote an efficient and complementary system for microfinance, it is desirable to reduce their risk perception of reaching the poor. One tool to deal with this issue is the Development Credit Authority (DCA).

b. Mainstreaming RRBs into Microfinance

CARE has launched a pilot project for transforming RRBs from investment groups to lending institutions, ensuring their sustainability through creating employee-owned banks. The "Strengthening Regional Rural Banks" pilot project will focus on West Bengal where nine RRBs are providing microfinance services to SHGs. While these RRBs have a good network of branches, good knowledge base about the area of operation, and have experience providing financial services, their branch-level staff lack experience in social intermediation and have developed poor attitudes towards SHGs. To address these issues, the project will implement a model consisting of three components:

i. Establishing a Nodal Agency at the Head Office staffed by two coordinators: one for Social Intermediation and Business Development Services, and the other for financial intermediation. The latter will be responsible for developing new financial products, implementing micro-finance products such as savings, credit, insurance, monitoring and evaluation, implementation of best practices in the SHGs, support in accounting and audit of SHGs.

ii. Establishing Mobile Guides at the branch level, primarily responsible for forming and nurturing SHGs, as well as creating clusters and federations of SHGs. These Mobile Guides will function independently from the branch.

iii. Appointing Micro-Finance Business Agents to the bank after it reaches a scale of business (expansion of SHGs). These agents will collect savings and provide credit to SHGs on a commission basis. The project may eventually formulate incentive schemes for these agents.

While the CARE project will address some of the constraints faced by RRBs, there is an opportunity for USAID to contribute to the success of the pilot effort. Funding site visits to selected countries with similar experiences and making available specialized technical assistance will ensure that the project objectives are met. RRBs offer an enormous potential for bringing microfinance services to most areas of the country.

III. USAID/I/PO Vision, Objective, and Strategic Interventions

3.1. Vision

A substantial number of the bypassed and the under served, especially women, will have access to full financial services in a sustainable manner, leading to their social and economic empowerment.

3.2. Objectives of the USAID/I Strategy

The main objectives of the proposed Mission's strategy are:
- Improve the capacity of financial markets, both formal and informal.
- Build technical and managerial capacities of microfinance institutions (MFIs) to help them achieve sustainability.
- Facilitate a regulatory framework that promotes efficiency of the MFIs.

3.3. Policy/Legal Concerns in Microfinance

There has been progress in legal reforms and also in mainstreaming microfinance; however, the policy/regulatory reforms that have been identified above are yet to take place. Among the most desirable reforms are the following:

3.3.1. Savings Mobilization:

There is a need to engage in policy dialogue with RBI to review the restrictions on savings mobilization by NGOs and Non-Banking Finance Companies. Except for cooperatives, no of the other legal forms are permitted to provide savings services.

3.3.2. Prudential Regulation and Supervision:

Although RBI feels that the sector is still too young to be regulated, there is a need to support self-regulatory efforts by MFIs.

3.3.3. Other Policy/Legal Concerns:

Additional policy concerns that needs to be addressed include: amendment of the Income Tax Act on the tax exemption status of NGOs involved in microfinance; measures to facilitate access to external funding and equity capital; and the creation of a new legal form for microfinance companies with capital requirements commensurate with the size of operations.

3.3.4. Performance and Reporting Standards:

Few performance standards have been developed that have not already been adopted by MFIs. Sa – Dhan is trying to build consensus among its members to agree on these standards and incorporate them into their reporting. There is a general need to speed up the development and adoption of performance standards and to take action in the regulation of MFIs

3.3.5. Proposed Interventions by USAID/I

While NABARD and RBI are playing a major role in spearheading policy and regulatory reforms, the network of microfinance institutions can play a catalytic role in speeding up the reform process. Sa-Dhan, a private network of industry leaders, is well poised to pursue the change in policy reforms as part of its policy advocacy role. Sa-Dhan has also taken a leadership role in developing performance standards; however, the network requires further support to carry out adequately both roles. Hence, if USAID provides specialized technical assistance to Sa-Dhan, it will enhance Sa-Dhan's capacity to do policy advocacy while developing and building consensus on performance standards among its partners. In this context, support should also be extended to develop Sa-Dhan's potential role as a Self-Regulatory Organization. The proposed intervention will strengthen Sa-Dhan substantially in all its three roles – policy advocacy, capacity building and setting standards. This, in turn, can help build sustainable MFIs.

There are other similar networks in the country: Indnet, a network of Grameen replicators; Micnet, a network of microfinance institutions in Karnataka; and Vani, a network of NGOs facilitating self help group formation. A realistic assessment must be undertaken before deciding on support these networks.

Support to Sa-Dhan is considered a priority strategic intervention for USAID/I and should include the following specific activities with estimated funding requirements:

- Workshops to highlight and analyze regulatory issues, with participation from expatriate technical assistance. Two workshops with funding of $100,000 should produce visible impacts during the first two years.
- Training in performance and accounting standards that is an essential step in developing the envisioned self-regulatory system. Proposed funding for this activity is $50,000 with expected results by the 2nd year.
- Technical assistance for setting performance and accounting standards. This activity will be linked to modern MIS and gain visible results by the 2nd year, requiring $50,000 in funding.

3.4. Capacity Building of MFIs

There is substantial funding available for capacity building in the microfinance sector through NABARD, SIDBI and RMK. However, utilization of funds does not comply with the growth and expectations of the sector.

3.4.1. Building Sustainable Microfinance Institutions

a. Replication of Proven Models – Franchises: One of the constraints to building sustainable microfinance institutions is the availability of technical know-how in tested and tried models of microfinance. Some institutions like BASIX and SHARE are in the growth and stabilization stage; they are operationally sustainable and they can be replicated.

BASIX has a very tentative plan to build more MFIs as franchises of its well-tested model of microfinance in India. Recently retired bankers will be targeted as potential franchisees. These bankers will be carefully selected to be exposed to some of the successful models, including BASIX, primarily through site visits and detailed studies. At the end of a one-month exposure visit, potential franchisees will choose the model they would like to replicate and will follow the start-up process to become a franchises. Nonetheless, owners will be required to raise their own start-up capital, ranging from Rs. 500,000 to Rs. 1,000,000. They will have initial access to loans. The parent organization will provide the required technical support to ensure a quick start up and fast outreach.

USAID/I should support BASIX's initiative of replicating successful models that have a minimal risk of failure and the possibility of rapid expansion. Through this initiative, USAID would continue to build the microfinance market in India. A careful assessment should preclude any decision on the nature and amount of support. A proposed amount for planning purposes is $500,000 with visible results starting the third year after establishing the franchises.

b. Strengthening Existing MFIs

i. **Infusion of Equity**:

Though it was originally envisioned that the Rs.1,000 million microfinance fund set up by NABARD would also provide start-up capital to MFIs, the current thinking has been to utilize the funds mostly for forming SHGs and training various partners involved in linkage banking. Consequently, there is likely to be paucity of equity funds for MFIs.

In addition, the present legal forms of microfinance institutions limit their ability to mobilize equity, as discussed in detail in the preceding sections and in the annexes.

Therefore, setting up an equity fund will help to infuse equity into MFIs that are on the path to becoming operationally and financially sustainable. This will help build sustainable organizations that, given an increased base equity, will be in a position to leverage commercial funding and scale-up operations. In other words, the equity fund should target strong MFIs by speeding up their access to commercial funds

USAID should give priority consideration to setting up an equity fund, preferably with SFMC, in the amount of $1,000,000 on an experimental basis in the first two years. Depending on the number of demand and usage, the fund may be augmented over the next three years.

ii. Incentive Fund:

An incentive fund is an alternative to the equity fund that ensures and accelerates reforms within the microfinance NGOs that lead to financial sustainability and increased customer outreach. NGOs are required to continue modernizing their systems and procedures, increasing productivity, improving the cost-effectiveness of their services, and maintaining an acceptable level of loans in arrears.

The incentive fund supports these efforts by rewarding the NGOs that implement the recommended reforms in a timely manner while maintaining acceptable financial performance standards. The targets and performance indicators identified in the strategic business plans will serve as trigger points for access to the incentives. NGOs who meet the planned targets will receive incentives in the form of financial bonuses on the outstanding loan portfolio financed by the incentive fund. The NGOs that do not meet the targets will not receive the incentive. The incentive fund will contribute to the transformation of NGOs into MACS (Mutually Aided Cooperative Societies) or NBFCs (Non-Banking Financial Companies) and eventually help MFIs raise resources from the public while introducing greater financial discipline in their operations. The Incentive Fund may be managed through a trust arrangement to be competed by ICICI, SIDBI, and FWWB. Annex 4 describes the major elements to be considered in the incentive fund. The incentive fund will be mostly directed at weaker MFIs willing to move along the path to financial sustainability.

USAID/I should also give priority consideration to setting up an incentive fund during the first two years. The proposed initial funding is $600,000, which can be augmented over the next three years based on results.

c. Practitioner Led In-country Training

At present, many of the staff of Indian MFIs are attending courses in Boulder, Colorado at Naropa University, where expert practitioners conduct a Microfinance Training Course. Thus far, few individuals were able to benefit from these courses, while a large number of practitioners were left out due to the high cost involved. Consequently, there is a need for making high quality courses available to the majority of in-country practitioners.

USAID should support a practitioner-led training program in India that can be conducted as a collaboration program between the Indian Institute of Management in Ahmedabad and Boulder Microfinance Course staff. Two such events can be planned in the next three years. Depending on demand for such programs, it might be possible to offer more sessions. The proposed funding for this activity is $100,000.

3.4.2. Strengthening Linkage Banking Model

a. Training for Sustainability of Grass Root Level Organizations

Although there are plenty of resources for training microfinance wholesalers and MFIs, there is no practical funding for training grassroots-level organisations. To address this constraint, USAID should support two organisations: CARE and FWWB. These organisations already have plans to set up capacity building resource centers as separate profit centers for training grassroots level organisations like SHGs, federations of SHGs, and the field staff of NGOs. Modest financial support could help establish the credentials of these organisations so that they can access the capacity building funds of the apex organisations. This support should also include technical assistance in developing and refining CARE and FWWB training modules, as well as in carrying out impact assessment studies and disseminating findings, which can help improve the design and delivery of microfinance services. While CARE has shared the project proposal, it appears that FWWB is yet to draw one up. CARE plans to utilise the available training infrastructure and develop accredited trainers at the district/block level to train the grassroot organisations. Their tentative business plan shows that the organisation will be self-sustainable in the medium term of five to seven years.

USAID support would total $200,000 ($100,000 for each participating institution after due diligence), with 50 percent for the start-up activities and the rest for technical assistance and dissemination. The expected results should be visible in the first years of the assistance (i.e., training modules, and impact assessments) with continued benefits during the remaining life of the project.

b. Mentoring

Mentoring is critical to the process of scaling up activities of small MFIs. It also helps build the microfinance market. Among the service providers that should be considered for support are: EDA Rural Systems, CARE's Academy for Microfinance, and Microfinance Consulting Group. Each organization works to establish sustainable organisations in the northern, central, eastern and southern states respectively. Ideally, these organisations should collaborate with SIDBI in this mentoring service because SIDBI has capacity building funds for this purpose and has an interest in building the microfinance market.

This support is considered necessary but not a priority for USAID funding. A proposed funding for this activity is $150,000, divided equally among the three potential participants for a five-year period.

c. Building new SHGs – Linkage between Microfinance and Health Sectors.

In previous sections, it has been discussed that one of the main constraints for expansion of the linkage model is the cost of SHG formation. In order to reach the goal of expand the outreach to 20 million families by year 2008 under the linkage-banking program, about $75 million is required for building new groups and improving the capacity of key players. Current funding available among wholesalers, mainly NABARD, may not last for more than two years for these purposes. Consequently, the program must identify complementary sources of funding for new group formation.

USAID/I is in a position to make a contribution to this need without committing additional resources. The USAID/I Health Office, through activities like its Mother-Child program, is funding the formation of women's groups. These activities offer an excellent opportunity for linking with the SHG model. Therefore, the Mission should examine the likelihood of furthering linkages between complementary activities of the Health and Program Development Offices. A pilot effort with CARE and CRS, the two beneficiaries of the PL 480 Program, must be given priority by the Mission's decision makers. It stands as an opportunity to make a contribution to the development of linkages between the microfinance and health sectors creating a win-win model proposition that would benefit other Missions as well.

3.5 Mainstreaming Microfinance

3.5.1 Enhancing the Role of Commercial Banks

Commercial banks' involvement in microfinance is negligible both in relation to the current volume of microfinance and to their broader engagement in rural and urban areas. The problem is compounded by bankers' lack of exposure to NGOs and MFIs, and their consequent inability to assess adequately the implementation capabilities of their potential clients. To address these constraints, USAID/I should support the following activities:

a. Providing technical assistance to IDRB (World Bank) to conduct a **training-of-the-trainers microfinance program** targeted to the faculty of training departments of commercial banks. This training should enable bankers to develop skills and knowledge in MFIs finance, including the rating and appraising of MFIs. Proposed funding $100,000.

b. Supporting **observation and study tours** abroad for key bank personnel to familiarize them with successful programs in Latin America (e.g. BancoSol in Bolivia; MIBANCO in Peru; BANCOADEMI in the Dominican Republic) and in neighboring countries, including the BRI experience in Indonesia. These tours will give senior bank representatives an opportunity to speak with their peers and understand the profit making opportunities that microfinance activities offer. SFMC and NABARD can arrange these tours. Proposed funding $150,000.

3.5.2 Developing Linkages with Capital Markets - DCA

One area requiring attention in order to partially service the unmet demand for microfinance services is the linkages with capital markets and formal financial intermediaries. One alternative is the use of the Development Credit Authority (DCA) made available by USAID/W. The DCA gives additional flexibility by allowing financial intermediaries to lend mobilized resources under its guarantee to any sector, thus effectively responding to market needs. This instrument may be used to encourage the formal financial sector to provide services to the poor in states that are striving to alleviate poverty. It is also useful to help establish profitable linkages between the formal financial sector and microfinance intermediaries. Under the DCA, USAID is authorized to provide loan guarantees on the outstanding portfolios that contribute to the objectives set out in the contract.

USAID/I will initially commit $500,000 to guarantee up to 50 percent of the micro and small business loan portfolios of banks that support financial deepening programs with a special emphasis on poor women. ICICI Bank, UTI bank, Global Trust Bank in the private sector and some public sector banks like Canara Bank and Oriental Bank of Commerce are potential candidates for receiving DCA funding during the first and second year of the program. Based on the results of this initial effort, funding could be increased during the third year with an additional $500,000.

3.5.3. Mainstreaming RRBs into Microfinance

CARE's "Strengthening RRBs" pilot project offers an excellent opportunity for mainstreaming

RRBs into microfinance. USAID/I should consider supporting this pilot effort by exposing RRBs senior staff and Financial Coordinators to **observation and study tours** to countries engaged in the transformation of development banks into profitable institutions providing microfinance services. One country to be considered is Guatemala, where its stated-owned Agricultural Development Bank (BANDESA) has been transformed to a mixed-capital bank

USAID/I should provide $200,000 for this activity. Based on the results of the pilot effort, the Mission may consider committing additional resources for dissemination of the pilot effort. Because CARE is already a PL 480 recipient, the Mission might consider allocating monetized food aid for dissemination purposes.

3.6. Promoting Innovations in Microfinance

3.6.1. Providing Micro Insurance Services

When examining the huge unmet demand and comprehensive work that needs to be undertaken at all levels in the area of micro insurance, it is clear that it will require considerable scope to support this initiative. USAID/I should support a few MFIs with a large outreach through training and exposure to interfacing with insurance companies and clients. Support should also be extended to insurance companies for the design and delivery of relevant and user-friendly insurance products. Training can be arranged through FWWB, which is presently developing desirable skills in this area. Proposed funding for this activity is $200,000. Expected results could be measured by the number of MFIs intermediating between insurance companies and clients and the number of clients accessing micro insurance services, and it should be visible by the 2nd year of the project.

3.6.2 Innovation Grants

USAID/I should make available resources for setting up Innovation Grants to foster and encourage innovative change and development among microfinance practitioners in India. Funding will target institutions with a strong track record that can demonstrate a thorough understanding of the microfinance sector and its linkages with other sectors. The grants will support development of new financial services as well as linkages between the microfinance sector and business development services. New financial services will include innovative ways of mobilizing savings from the informal sector and business community in general, insurance and leasing (a contractual mode for transferring the use of equipment, land, or machinery in consideration of payment in the form of rent). It will also include new products for commercial banks to reduce the transaction costs of doing business with the microfinance sector, among them: credit card operations (having their own credit card brand) and the introduction of smart cards.

The Innovation Grants could be managed by FWWB and would fund proposals during the first and second year of the project to ensure adequate monitoring and completion of proposed activities.

Proposed funding for this activity amounts to $500,000 for the first two years. Although necessary, this activity is not a priority at present.

3.6.3. Promoting Action Research and Policy Studies

USAID/I should support **Action Research and Documentation** successful in-country microfinance experiences by way of case studies and papers. The Mission should also support **Policy Related Studies** to enable a supportive environment for the microfinance sector. Sa-Dhan is proposed for a "quick and dirty" action research and documentation project. The Indian Institute of Management in Ahmedabad is proposed for policy-related research studies, jointly with renowned universities like Ohio State. Proposed funding for this activity is $300,000 for policy related studies and $100,000 for "quick and dirty" action research studies.

3.6.4 Supporting High-Level Policy Seminars

USAID/I should support annual high-level policy seminars based on studies jointly carried out in collaboration with renowned universities like Ohio State. NABARD and SFMC should spearhead these seminars by ensuring the participation of policy makers, bankers, and the managers of key MFIs. Proposed funding for this activity is $250,000 for a five-year period.

3.6.5. Promoting Donor Coordination

Contradictory donor policies will undermine USAID's efforts in strengthening the microfinancial sector and thus its efforts to assist the poor. Therefore, USAID/I should promote donor-coordinated activities to support the development of the microfinance sector. The Mission can take the lead in setting up regular coordination meetings with the major donors in the area of micro and small enterprise finance to discuss policy and strategies among the donors. Sa-Dhan could play a role of Technical Secretariat for this activity. To the extent possible, the donor dialogue should focus on the following areas:

- Promoting financial policies that reflect market conditions.
- Promoting and developing standardized performance measurements (CAMEL type) in coordination with other donors.
- Promoting and developing standardized financial reporting among the donor community.
- Disseminating updated information on best practices and share studies and experiences with the donor community, GOI and practitioners.
- Participating and/or hosting meetings with the donor community periodically to discuss advances and issues that affect the sector.
- Promoting the participation of other donors in support of business development services.

Proposed funding for this activity is $ 50,000 during the first two years.

ANNEX 1: THE MAJOR PLAYERS IN THE MICRO FINANCE SECTOR IN INDIA

1. National Bank for Agriculture and Rural Development, (NABARD)

NABARD, the apex organization for agriculture and rural development, is promoting micro finance activities. They are playing a crucial role in the widening and deepening of the Self-Help Group (SHG) bank linkage program. Self-help groups are voluntary associations of poor who mobilize their small savings and use it initially for lending among themselves. If the SHG is sustainable for six months, it is eligible to be linked with a formal financial institution in order to meet credit needs. The linkage program has been very successful; during the year ending March 31, 2001, nearly 68,000 groups have been linked with 8500 bank branches. Thus, since the beginning of the program, bank credit has been extended to an estimated 4.4 million households through 262,000 SHGs. Presently more than 700 NGOs are promoting SHGs and linking them with banks. In addition to NGOs, some Regional Rural Banks, cooperative and commercial banks and grass root level organizations like VVV clubs11 are also acting as self help promoting institutions. NABARD has a target of linking one million groups with formal banks by 2008. In order to form and nurture one million groups, NABARD has estimated that nearly 4000 NGOs and SHPIs would have to become involved.

NABARD also provides bulk finance to NGOs directly to facilitate their on-lending to either individuals or SHGs. Apart from refinance and finance, NABARD supports a wide variety of promotion and capacity building activities. Capacity building of partner NGOs, banks and SHG members is a core objective of NABARD's linkage banking program. NABARD also carries out its own studies as well as commissioning studies by other organizations.

NABARD has set up a Microfinance Fund of Rs. 1000 million rupees to be used for financing innovations, and capacity building of various organizations involved in linkage banking.

Currently, micro enterprise development is not the core objective among SHG members. However, it is likely to develop as the main thrust of development in the future. Micro enterprise development will be especially important in strengthening the credit absorption capacity of the SHGs and in improving the income of their members.

2. SIDBI Foundation for Micro Credit (SFMC)

In November 1998, the Small Industries Development Bank of India (SIDBI) set up the "SIDBI Foundation for Micro Credit" (SFMC) with an initial corpus of Rs.1 billion. The major objective is to raise the standard of living for the poor by meeting their genuine credit needs with focus on women. The main activity of the foundation is to provide financial support to well managed

11 VVV stands for Vikas Volunteer Vahini under which farmer's clubs are formed by bank branches (with part funding by NABARD). The members of the farmers clubs or animators engaged by them promote self-help groups. As per NABARD annual report March 2000, there are 4354 VVV farmers clubs in 385 districts covering 22 states.

Microfinance Institutions12 (MFIs) for on-lending to poor (individuals / groups) with an emphasis on women who take up industrial activities at a micro level. Support is also extended to MFIs for strengthening their financial, technical and managerial capabilities, as well as for improving their credit absorption capacity.

The MFIs can finance all activities that can be classified as "non-farm". Assistance by way of loans, subject to a minimum of Rs. 1 million, is provided for the purpose of on-lending. However, need based support in the form of grants is also provided to MFIs in order to strengthen their financial, technical, managerial and infrastructure capabilities, as well as to improve their credit delivery and usage capacity. SFMC engages the services of EDA Rural Systems to provide a credit rating to the MFIs. This is followed by a detailed institutional capacity assessment of the MFI.

Financial support is extended to NGOs for training interventions in the area of maintenance of accounts, bookkeeping, credit management, identification and selection of income generation activities as well as management of micro-enterprises.

As of March 2001, the organization is working with 40 MFIs (some of the largest institutions in India) and has dispensed around Rs. 60 crores of credit to them.

3. Rashtriya Mahila Kosh

The main objective of Rashtriya Mahila Kosh13 (RMK) is to facilitate credit support or micro-finance to poor women as an instrument of socio-economic change and development. It has a corpus fund of Rs.31 crore. RMK mainly channels its support through NGO's, Women Development Corporations, Cooperative Societies, Indira Mahila Block Samities under the Indira Mahila Yojana,14 and other state government agencies. Rashtriya Mahila Kosh has approved credit limits of Rs. 14.72 crores to benefit 47,458 women up to January 31, 2000 through 224 new NGOs and organizations working in 19 states. RMK is working with nearly 300 organizations including some of the small MFIs and SHGs. RMK also organizes awareness programs for partner organizations to create understanding of RMK's schemes.

4. Friends of Women's World Banking

Friends of Women's World Banking (FWWB), an affiliate of Women's World Banking, is a second tier microfinance institution lending to partner organizations working with poor women. At present, it is financing about 71 MFIs including some self help groups. As the apex level MFI, it is also involved in the development of the microfinance sector. FWWB provides technical assistance to partner organizations, institution building of small MFIs. FWWB also undertakes special projects in

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12 The MFIs supported under this imitative are Societies registered under Societies Act, 1860 or similar State Acts, Trusts Registered under Public Trusts Act, 1920, Section 25 companies, Federation of Self- Help Groups, Non Banking Financial Companies focusing on banking with the poor, Specialised Cooperative sector institutions such as Mutually Aided Cooperative Societies, Other Co-operatives and new type of institutions with focus on banking with the rural areas, e.g. Local Area Banks.

13 (RMK) was constituted as a Registered Society under the Societies Registration Act, 1860, sponsored by the Deptt. of Women & Child Development, Ministry of Human Resource Development, Govt. of India, in 1993.

14 Indira Mahila Yojana (IMY) is a scheme run by the Central Government, Department of Women and Child Development, with the objective of empowerment of women.

new areas of poverty reduction such as development of community infrastructure and micro insurance. In addition, FWWB provides training, capacity building and mentoring services to partner NGOs and MFIs.

5. Women Development Corporations

Six women development corporations are participating in the Swa Shakti15 project. Tamil Nadu Corporation for Women Development Ltd. is implementing Mahalir Thittam,16 a women empowerment project where the formation of self-help groups and federations of SHGs is the major objective17. There are 79,800 SHGs with membership of 1.4 million women under Mahalir Thittam.

6. Multi-lateral and Bi-lateral Agencies

Several multilateral and 13 bilateral donors provide assistance to India. Among them:

6.1. World Bank

World Bank has some major projects with components of microfinance and micro enterprise development. Two of its main projects are:

a. Swa Shakti: a women empowerment project being implemented in six states – Gujarat, Madhya Pradesh, Bihar, Uttar Pradesh, Haryana and Karnataka. The project envisages mobilizing rural women into self-help groups and taking up need based social and economic activities. Micro enterprise development is a major component of the project. The project outlay is about Rs. 256 crores and the budget for training and workshops is nearly Rs. 50 crores. This includes project related internal workshops, however a sizeable component is for training grass root level organizations and NGO personnel.

b. U. P. Land Reclamation Project: This project involves reclaiming saline lands and is being implemented by Uttar Pradesh Land Development Corporation in ten districts of Uttar Pradesh. Microfinance through SHGs is a sizeable component of the project. The water user groups and women savings and credit groups formed under the project are to be linked with banks for meeting their credit needs. The project outlay is Rs. 1,469 crores out of which 5 per cent is earmarked for institutional development and capacity building. Some of the project sub-components are capacity building and training of groups, NGOs, project staff, line departments and bankers involved in the project. The project will be implemented until 2003.

15 Swa Shakthi is a project of the Department of Women and Child Development, Government of India, funded by the World Bank. Details given in a later paragraph on World Bank projects.

16 Mahalir Thittam is a Tamil phrase meaning Plan or Program for Women.

17 The Tamil Nadu Corporation has developed useful modules over the years for training the government departments, NGOs and group leaders. The Tamil Nadu Government has planned to set up a NGO resource and voluntary center in the state for providing resource input to the NGOs and for promoting volunteerism. The Corporation will manage the Centre.

6.2. USAID

The United States is the seventh largest donor after the World Bank, the Asian Development Bank, the European Union, Japan, Germany and the United Kingdom. USAID collaborates closely with other donors on reproductive health, HIV/AIDS and other infectious diseases, population, climate change, urban environmental infrastructure and women's empowerment. USAID's programs seek to increase women's decision-making power by supporting indigenous organizations, girls' school participation and combating violence against women. To date, USAID has had minimal involvement in microfinance.

6.3. Asian Development Bank

The Asian Development Bank (ADB) plans to support 17 projects in India by contributing US$4 billion during the period 2001-2003. Significantly, poverty intervention projects constitute about 35 percent of both the number of projects and their total value. During the same period, ADB will support 35 technical assistance programs totaling US$25.5 million. These include capacity building for social development and poverty reduction at the state level, poverty mapping, poverty reduction in Sundarbans in West Bengal, rural poverty reduction, community participation in environmental/sanitation investments, and new urban development/poverty loan projects in Calcutta and Madhya Pradesh.

The bank has a large presence in the micro housing sector. The Housing Finance Project of the bank will offer lines of credit to HUDCO, NHB, HDFC, and ICICI Home Finance in order to finance housing and housing-related poverty reduction sub-projects. All clients will be low-income households with an average monthly household income of less than (Rs) 7,000. Recently, the ADB sanctioned a grant to HUDCO for capacity building of their micro finance and micro housing offices.

6.4. DFID

DFID is the major donor in microfinance supporting two major programs: the SIDBI Fund for Microfinance and the CASHE project of CARE. The financial commitment to these projects is in the amount of Pound Sterling 26 million.

6.5. Swiss Agency for Development Cooperation (SDC)

SDC has been involved in microfinance related activities for a long time. It has supported NABARD, SIDBI and others in the development of micro finance, especially through the SHG mode. Their support is mainly made available for human resource capacity building and institution building.

6.6. KFW and GTZ

These German development agencies are also active on the microfinance scene in India. They are also active in other projects such as watershed development, tribal development, etc. Microfinance is an integral part of all of their projects. They provide technical assistance and financial support to NGOs, banks and other development agencies.

6.7. CIDA

Two major programs of CIDA are the Gender Equality Fund (until 2003) and community based economic development (until 2005).

a. **The Gender Equality Fund** ($0.5 million) is designed to respond to the needs and priorities of women in India through support to local NGOs, institutions and agencies for initiatives that promote gender equality and women's empowerment.

b. **The Community Based Economic Development ($4 million)** aims to strengthen civil society, develop economically viable community based economic organizations, and to promote sustainable management of local resources. The six areas of focus for the community-based organizations (CBO's) are: microfinance, income generation, community forestry, decentralization, policy feedback, and gender.

6.8. NOVIB

Food security is the core objective of NOVIB's program and most of the 40 NOVIB partner NGOs are involved in formation of self-help groups and federations. NOVIB provides grants to its partners for their programs as well as capacity building of NGO staff and the groups.

6.9. Ford Foundation

One of the major programs of the Foundation in India is the Women's Livelihoods and Empowerment Program. This program supports efforts to increase the outreach and sustainability of development finance and supportive livelihoods programs as well as to expand the provision of financial services by mainstream financial institutions to poor women. To achieve these goals, the program concentrates on professionalizing key development finance and livelihoods programs. The inputs focus on increasing their planning, management, evaluation and research capacity and strengthening policies and institutions that provide a bridge between NGO, government and mainstream banking programs. Some of the organizations supported by Ford Foundation are the DHAN Foundation, EDA Rural Systems, and the FWWB.

7. Other projects.

There could be more donor projects in which the development of community based organizations, microfinance, micro enterprise development, and business development services have a sizeable component. Such projects are in the area of watershed management, water resource management, forestry management, and health and environment. Most of the donors have gender concerns and build in economic and social empowerment of poor as part of their projects.

8. Insurance Services to the Poor

Until recently, the insurance industry had been state owned. The life insurance business was managed exclusively by the Life Insurance Corporation of India (LIC); the non-life insurance products were managed by General Insurance Company and its four subsidiaries. With the recent opening of insurance sector for private companies, there are thirteen entrants and prospective entrants in the life insurance industry and eleven new and prospective entrants in the non-life sector.

LIC is a giant with 2046 branches18. LIC has nearly 62 products covering various needs such as old age pension, child education, marriage, life insurance, etc., LIC implements subsidized group insurance schemes aimed at socially vulnerable classes19 which seek to cover many poor, however the coverage is very limited. General Insurance Corporation and its public sector associates had the monopoly of non-life insurance until the sector opened up recently. General insurance has a low presence in rural India where the majority of the population lives. Only 5.2% of premiums are generated from rural areas20. Despite a wide product range of policies offered in the rural areas (from insurance of large commercial plantations to individual cattle), few policies have been written compared to the potential. Insistence of banks on borrowers buying insurance coverage on assets acquired through loans has accounted for a significant part of the rural non-life insurance business.

The Insurance Regulatory Development Authority stipulates that the non-life insurance companies should increase their rural coverage, reaching a level of 5 percent of total policies written, over a three-year period. Similarly, life insurance companies should increase their rural business to reach a level of 15 percent of policies written over a five-year period. Thus minimum targets have been fixed to cover the rural and socially backward population. The insurance services that are offered to the low-income households are currently state driven.

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18 The company has more than 120,000 employees and 600,000 active agents. During 1999- 2000, LIC issued 16 million new policies, with an average value of Rs 50000 (US $1100). LIC underwrites currently 50 % of its policies from rural areas.

19 The corporation has been implementing a social security insurance program since the 1980s. In 2000, the Government of India and LIC has designed a new scheme under the social sector. The scheme covers 23 approved occupations including micro enterprises of the self-employed. The scheme is not widely known and the coverage is very poor - only 204,000 persons have been covered in the last year.

20 This does not include crop insurance coverage which is a different product, sold differently and not on a commercial basis since the premium charged is not on actuarial basis but is determined by the government and offered as a subsidised product.

ANNEX 2: ROLE OF DIFFERENT STAKEHOLDERS IN LINKAGE-BANKING

Donors
The major donors who have been involved in microfinance either directly or indirectly have been the World Bank, IFAD, DFID, SDC, GTZ, Ford Foundation, SIDA, USAID, and others.

Funding the programs and NGOs' costs for mobilization of the poor, especially women, for meeting their financial and social needs resulting in empowerment of poor.
Promoting sustainable community based organizations.
Enhancing food security and livelihood options.
Capacity building of staff and grassroots-level members.
Seed capital for enterprises of clients.
Seed capital for grass root level institutions.

NABARD

Policy framework for financing banks in coordination with RBI.
Refinance to financing banks.
Large scale financial and technical support for capacity building of various players.
Promotion of other self-help promotion institutions such as VVV clubs, bank personnel, etc.
Awareness building on the concept of self-help groups by documentation and dissemination.
Building partnerships between NGOs and banks.
Awareness and capacity building of Government staff.
Enabling sustainable financial services to the poor and low-income households.

Non-Government Organizations (acting as facilitators)
Formation and nurturing of self help groups and other grass root level organizations such as federations for meeting their financial as well as social needs.
Capacity building of groups, especially leaders.
Making the grass root level organizations are bankable.
Ensuring sustainability of grass root level organizations
Policy advocacy.

Banks

Lending to the self-help groups and federations on a sustainable basis.
Linking up with Government sponsored programs wherever desirable.
Innovations to make the linkage program profitable and sustainable.
Promotion of self-help groups (in selective branches).

Self-help Groups and other Functional Groups
Mobilizing small savings of members.
Lending as per the needs of members.
Taking up common and community development issues.
Linking up with banks and Government departments for mobilizing resources.

ANNEX 3: MAIN STAKEHOLDERS SPECIALIZED IN MICROFINANCE OPERATIONS

Wholesale Microfinance Institutions

These include: SIDBI fund for Microfinance, Rashtriya Mahila Kosh and Friends' of Women's World Banking. NABARD also provides revolving fund assistance directly to some of the MFIs/networks.

The Wholesale MFIs' support include:

- Lending to NGOs/ MFIs/ Federations/SHGs;
- Grant support for capacity building;
- Organizing training events for their constituents.

Retail Microfinance Institutions

These include specialist institutions such as ICNW, SEWA bank, BASIX etc., as well as NGOs who have converted to financial intermediaries.

The Retail MFIs' role include:

- Lending to clients;
- Mobilizing savings of clients including voluntary savings (only few offer this service);
- Training and capacity building of clients.

ANNEX 4. ELEMENTS OF THE INCENTIVE FUND

5.1. Objectives

The incentive fund will support the following objectives:

- Promote increased access to financial services and client outreach at the regional level;
- Accelerate financial reforms and promote the financial sustainability of the microfinance intermediaries, using best practices;
- Prepare the microfinance intermediaries to become regulated financial intermediaries;
- Improve the quality of the reporting and accountability of the MFIs.

5.2. Focus of the Incentive Fund

- Reward the winners;
- Improve the outreach (number of clients), geographical coverage and services provided to clients;
- Strengthen and introduce market financial policies in the MFIs to promote financial self-sufficiency;
- Create a business culture within the MFIs;
- Promote in the MFIs the need for strategic and business planning and its implementation;
- Develop efficiency indicators and establish targets that have to be met by the microfinance intermediary;
- Use the incentive fund resources to finance new activities that have been established in the strategic and business plans.

5.3. Major Aspects of the Methodology

The requirements for accessing the incentive fund are the following:

- Undergo a CAMEL-type analysis and be rated;
- Develop and implement a business plan with clear efficiency indicators and targets that have to be met;
- Provide monthly financial statements and management reports accordingly to the standardized format that will developed for this purpose;
- Be subject to an evaluation every six months to monitor progress against the indicators and targets.

Initially, the MFIs will pay market rates of interest for the use of funds under the incentive fund. If the MFIs meet the targets and indicators established for the first year, they would get a bonus. This bonus will be equal to the difference between the market rate and the average savings mobilization cost of the commercial banks plus the weighted average management fee of the funds. The MFIs that meet the indicators and targets established for the second year will get a second bonus, which will consist of the elimination of interest rates, except for the management fee. If, at the end of the third year, the MFIs meet the agreed targets and indicators, the incentive fund loan will become a grant to the organization. MFIs do not meet the target and indicators will pay either the market rates or a reduced rate based on their performance during the three-year period. These MFIs will have to repay the incentive fund as initially established.

5.4. **Management of the Incentive Fund**

The incentive fund will be managed under a competitive fiduciary agreement with a commercial bank or any other bank that USAID/I will choose.

ANNEX 5: MICROFINANCE – A TOOL TO ADDRESS POVERTY21

6.1. Poverty and Finance

Historically, poverty was viewed as a problem of the poor earning too little income, consuming too little to attain a socially acceptable standard of living, and possessing too few assets to protect themselves against unforeseen problems. Poverty alleviation strategies, therefore, have usually included employment creation, sometimes skill development and, occasionally, redistribution of assets from the rich to the poor. Technological change for small farmers has been a part of most rural poverty programs. Improving access to financial services, especially credit, has often been viewed as an important weapon in fighting rural poverty. These loans were expected to increase production and raise incomes, permit greater consumption and savings, and lead to further investment. In this traditional view, finance was largely limited to the single role of augmenting production through granting loans to producers, often at concessional interest rates.

Poverty analysts argued during the last decades that this traditional view of poverty is too narrow and simplistic. The World Development Report 2000/2001 of the World Bank notes that poverty involves multiple dimensions. Not only do the poor lack income; they lack adequate food, shelter, education and health. They face extreme vulnerability to ill health, economic dislocation, and natural disasters. They are often exposed to unfair treatment by state institutions and are powerless to influence the many decisions that affect their lives.

Paralleling this evolution in perceptions about poverty has been an evolution in understanding the role of finance in development. Financial services are recognized now as playing multiple roles so that improved access can have a far greater and more comprehensive impact on poor households than previously assumed. In addition to inducing an increased production and investment cycle, access to financial services can produce other desirable incomes such as consumption smoothing and improved food security. Moreover, supplying financial services to women in traditional societies may be especially important as a way to empower them so they play more active economic and social roles in society.

6.2. Microfinance: The Win-Win Proposition

Microfinance organizations provide financial services, usually in the form of small sized financial transactions, to people who are unable to access such services from commercial institutions. They are usually among the poorest members of all societies. Commercial banks tend to ignore the poor in order to avoid the high transaction costs of servicing many small loans and savings deposits. Moreover, most of the poor do not possess assets normally demanded as collateral by commercial lenders and they are perceived as being too risky to be granted loans.

The microfinance industry has experienced explosive growth during the 1990s. This industry

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21 Excerpts from Richard Meyer's Paper "Microfinance, Poverty Alleviation, and Improving Food Security: Implications for India," 2001.

consists of non-governmental organizations (NGOs), village banks, credit unions, specialized banks for the poor, and commercial banks. A large segment of the industry operates on a win-win proposition: the poor benefits from the financial services provided, willingly pay high interest rates and fees to obtain them, which permits the MFIs to provide the services on a sustainable basis. Therefore, MFIs that follow good banking principles are also expected to be those that alleviate the most poverty.

The microfinance industry and individual MFIs are evaluated on the ability to achieve three objectives: The first is outreach that is to reach a large number of poor clients. The second is long-term sustainability, so that the FMI can continue providing financial services after any initial start-up funds have been exhausted. The third is impact on the clients served. There are complementarities among these objectives. For example, MFIs that serve a large number of clients may achieve economies of scale that contributes to their sustainability. But there may also be trade-offs. If MFIs try to serve very poor clients, loans and savings deposits will be smaller and costs will be higher, so sustainability may be more difficult to achieve.

The objective of institutional sustainability is one of the most fundamental changes in the paradigm shift from directed agricultural credit to market-oriented microfinance. The objective is difficult to achieve; however, there are a few successful institutions, such as the Unit Desa System of Bank Rakyat Indonesia (BRI) serving several millions of rural clients. BancoSol in Bolivia, MIBANCO in Peru, and BancoAdemi in the Dominican Republic are examples of NGOs that successfully converted into specialized banks for the poor. The problem is that less than one percent of all MFIs have reached the ability to cover costs and mobilize funds on a commercial basis. That is one reason why some MFIs are beginning to aggressively mobilize voluntary savings rather than rely exclusively on donors or governmental funds, and they are experimenting with leasing, insurance and other financial services to attract more clients and increase revenues.

ANNEX 6: COMMERCIAL BANKS ROLE IN MICROFINANCE – CURRENT STATUS

The policies concerning rural credit through the banking system were hitherto pursued on a set of assumptions, such as: (1) the rural poor have no capacity to save, (2) rural credit could only be developed through subsidy linked-poverty alleviation credit programs, and (3) the interest rates of credit from informal sources were exploitative. These assumptions led to a policy orientation focused on capital subsidies and low rates of interest on loans; target-oriented poverty alleviation programs; credit guarantees for small loans; the fixing up of sectoral targets for disbursement of credit; soft lending terms including no or very low down payments; long maturities and grace periods; relegation of savings as a source of funds; and increasing the rural credit system's reliance on concessional refinancing from higher financial institutions.

In this environment, India looked to its large bank network as the primary way to supply microfinance services. This approach was in line with the country's tradition of a top-down, non-market strategy of mandates, quotas, and refinancing to expand access to financial services for priority sectors. The microfinance strategy also continued the strong bias towards emphasizing targets for outreach rather than stressing financial efficiency and self-sustainability (sometimes called "directed credit"). Policymakers were encumbered by the view that the poor could not save and therefore needed subsidized loans. Therefore, there was relatively little official concern for savings mobilization and other financial products. Although some liberalization occurred, the financial system was still constrained by governmental regulations. State-owned or controlled banks and cooperatives thwarted the development of non-bank financial institutions and other types of MFIs that attempted to operate on a commercial basis.

The most relevant policy action affecting MFIs took place on April 1999, when the Reserve Bank of India lifted ceilings on interest rates for micro-credit organizations by determining that "interest rate applicable to loans given by banks to micro-credit organizations or by micro-credit organizations to Self-Help Groups/member beneficiaries will be left to their discretion." The policy document (RPCD No. PL.BC.94.09.01/98-99) specified that the micro-credit organizations would include institutions "such as Non-Governmental Organizations, Federations of Self Help Groups, Mutually Aided Cooperative societies, etc."

While RRBs and cooperative banks are not subject to any interest rate regulation even for direct microfinance, the deregulation of interest rates has not had any practical impact on the availability of credit to small borrowers. The reason for this is that perceived political and social pressures have limited the interest charged by RRBs and cooperative banks to the levels charged by commercial banks on loans less than Rs25,000. The only form of regulation still applicable for microfinance by the banking system is that the rate of interest charged by commercial banks to the final borrower is capped by the prevailing prime lending rate. In early 2000, prime lending rates of most commercial banks were around 15 percent per annum.

In the current economic environment in India, however, the issue of interest rates may be different from the presumed upward pressure on lending rates, which might be expected due to deregulation. With annual inflation rates ranging from 3 to5 percent, bank-lending rates of 15 to 18 percent per annum are now quite high in real terms. Therefore, in the long-run, the issue for RRBs, local area banks (LABs) and cooperative banks may not be so much whether or not they are able to increase their lending rates substantially as whether they can improve efficiency to levels at which even the current lending rates may be profitable.

It should also be noted that the policy document stated: "The interest rate ceilings applicable to direct loans given by banks to individual borrowers will continue." This decision may have implications for expanding banks' outreach, as it would limit financing SHG members that require higher levels of funding for business expansion. The empirical evidence shows that those members make a contribution to poverty alleviation as they become a source for job creation. Therefore, if microfinance is to make a dent on poverty alleviation, and commercial banks are to play a role in this process, this measure may need further consideration by policy makers.

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